BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

I.

OPINIONS OF THE COURTS BELOW

The opinion of the Board of Tax Appeals is reported in 39 B. T. A. 712 and the opinion of the U. S. Circuit Court of Appeals for the Sixth Circuit is reported in 117 Federal Reporter (2nd), p. 917.

II.

JURISDICTION

Jurisdiction is invoked under Section 240 (a) of the Judicial Code, as amended by Act of February 13, 1925, 43 Stat. 938.

The decision of the Circuit Court of Appeals was entered on February 14, 1941. A petition for rehearing was duly filed and denied without opinion on March 14, 1941.

III.

STATEMENT OF THE CASE

A concise statement of the case containing all that is material, in the opinion of the petitioner, to a consideration of the questions presented appears under "Summary Statement of Matter Involved" in the preceding petition.

IV.

SPECIFICATION OF ERRORS

The errors in the decision of the Circuit Court of Appeals which are relied upon by the petitioner are set forth in the divisions of the petition under the headings "The Board's Reasons for Rejecting Its Own Findings of Fact," p. 5, *Supra,* "The Reasons of the Circuit Court of Appeals for Rejecting the Board's Findings of Fact," p. 6, *Supra,* and "Reasons Relied Upon for Allowance of the Writ," p. 8, *Supra.* The petitioner will rely upon and urge before this Court all the errors therein assigned which are now adopted for the purpose of this brief.

V.

ARGUMENT

(a) Preliminary Statement

Underlying all of the errors assigned, is the protest of the petitioner against the express acceptance by the Circuit Court of Appeals of the language of the agreement of settlement dated November 7, 1932 (Exhibit 7, R. 46, 77) as the exclusive basis for determining the substance of the transaction. The fact is ignored that such agreement event as literally construed under the parol evidence rule which is here inapplicable, fails to support the conclusion that the cost was $62,000.00; the literal construction of such agreement provides for a cost of $72,467.00. But the Court has assumed a series of facts in contradiction of all the evidence in the record and the express findings of fact of the Board. The Board of Tax Appeals on the other hand, places its decision on a single simple ground. Hav-

ing found as a fact that damages were sustained and that the York Corporation had agreed (R. 27) to allow $84,800.00 as such damages against the cost under the contract of October 10, 1930, (Exhibit 1, R. 39, 53) it rejects the inescapable consequences of such findings. *The basis for the rejection is not any finding that the parties subsequently intended to alter or change such agreement.* The conclusion of the Board is made to rest entirely upon the language in the second contract providing for the cancellation and recission of the rights of the parties under the first contract. If it is assumed that the only unexecuted obligation was on the part of the petitioner and such obligation was to pay the balance of $50,000 (included in the aggregate obligation acknowledged in the second contract) it is surely understandable that the parties should provide for the cancellation of the earlier and duplicate expression of liability.

(b) The Refusal of the Circuit Court to Adopt the Facts as Found by the Board

In appeals from decisions of the Board of Tax Appeals, it is the settled rule that both the petitioner and the Court are bound by the Board's express findings of fact.

Powers Manufacturing Co. v. Commissioner (C. C. A. 8), Fed. (2d) 225;
Avery v. Commissioner (C. C. A. 5), 22 Fed. (2d) 6;
Tracy, et al., v. Commissioner (C. C. A. 6), 53 Fed. (2d) 575.

The primary function of an Appellate Court in appeals from decisions of the Board of Tax Appeals is to determine *"whether or not the facts found sustain the legal conclusions reached." Belridge Oil Co. v. Helvering* (C. C. A. 9), 69 Fed. (2d) 432.

It is likewise settled that the substance of the transaction and not its form constitutes the basis for tax liability; and the Commissioner is as definitely precluded from invoking the form of the transaction to support his claim for taxes as the taxpayer is from invoking the form to escape taxes. Thus in *Prairie Oil & Gas Co. v. Motter*, 66 Fed. (2d) 309 at 311 (C. C. A. 10), the Court said:

> "His position (that of the Collector of Internal Revenue) is that the Court should close its eyes to the events prior to April 1st, and consider only the fact that the Prairie owned all the Olean stock on that day; that it then transferred to the Prairie all its properties in consideration of a cancellation of its stock. If a taxpayer sought to avoid a tax on the profits of such a sale as this by asking the Commissioner to ignore the actualities, he would shortly and properly be reminded that taxation *is an intensely practical matter and that the substance of the thing done, and not the form it took, must govern.*"

The substance of the transaction admits of no controversy. The basis of cost as established by Exhibit 1 was $146,800.00. Was there any change in this cost? The Board's express finding is that damages were agreed to be allowed against such cost. The parties had been negotiating for months as to the amount of damages. A protracted examination of the books of the Petitioner wherein the losses were currently recorded had been made by the York Corporation. The Board of Tax Appeals found (R. 26, 27):

> "In the Fall of 1932, the negotiations (to determine the amount of the damages) culminated in an understanding that the York Corporation would allow an adjustment on the transaction in the total sum of $84,800.00 arrived at as follows:

(Here the Board set forth in its opinion the items of damages recognized by both parties as making up such sum of $84,800.00).

"Total amount agreed upon as damages and set off against the liability... $84,800.00"

Counsel for the respondent stipulated at the hearing (R. 44) that the letter signed by the York Corporation (Exhibit 6, R. 43, 74) did show "how the calculation (of damages) was made." The failure by the Court to take notice of the agreement, established by the record and found by the Board, to pay damages in the amount of $84,800.00, is in deviation of the express stipulation of the respondent's counsel *that the damages were in fact calculated by the York Corporation in the amount of $84,800.00 as shown by Exhibit 6.*

The entire question of damages was a matter of the most deliberate and meticulous calculation between the parties. By Exhibit 2 (R. 41, 68), being a letter from the York Corporation to the petitioner, the question of damages is referred to and an arrangement is made to examine the books of the petitioner in Detroit. It appears from Exhibit 3 (R. 41, 69), that on April 20, 1932, the petitioner had telegraphed the York Corporation as follows:

"Have your letter April 12. Books open for your inspection at any time."

By Exhibit 4 (R. 41, 70), reference is made to the data taken from the books and to the proposed discussion on the basis of such data. By Exhibit 5 (R. 41, 70), on the basis of detailed calculations made from the books of the petitioner and enclosed in the letter, the York Corporation suggests "that the grand total estimated loss is $20,342.67." According to its sales executive such sum

of $20,342.67 represented the York Corporation's estimate of the damages which had accrued only to June 16, 1932 and only upon the items then dealt with (R. 47).

It is not the purpose of counsel completely to review the uncontradicted evidence with respect to the damages suffered and the consistent and repeated admissions of liability on the part of the York Corporation. Over a period of many months while the negotiations were proceeding, the York Corporation admitted verbally and in writing on many occasions its liability for damages and its desire to pay damages; and the Board has found an express agreement to pay damages in the amount of $84,800.00.

To apply to the agreement whose only purpose it was to state and settle the full account between the parties and to preclude a reassertion of claims on the warranty, an interpretation contrary to the substance of the transaction, is without warrant even if the parol evidence rule applied. *The very execution of the agreement confirmed the antecedent satisfaction of the liability in the amount agreed upon.* The purpose of the agreement in the words of the Sales Manager of the York Corporation (R. 45) was "to clear themselves from further liability under this contract" (of October 10, 1930). It was the method agreed upon by the parties, as found by the Board (R. 27), of manifesting the settlement of "the difference between the petitioner and the York Corporation" instead of a credit memorandum for damages "in the amount of $84,800.00, agreed upon, against petitioner's liability under the original contract." The proposal of executing a new agreement was adopted (R. 27), "to dispose of the matter and to fix the liabilities and rights of the parties with respect to the said machinery." The claim for damages having thus been satisfied by the acceptance by the York Corporation

of an acknowledgment by the petitioner of the smaller unpaid balance resulting from the application of the credit, the new contract establishing the changed account was drawn. The suggestion came from the York Corporation "in order to clear themselves from further liability under this (October 10, 1930) contract" (R. 45). The remaining liability of $50,000 "with respect to the said machinery" having been included in the acknowledged liability of $60,467 secured and preserved by the new contract, the expression of the money obligation as originally fixed by the contract of October 10, 1930 (Exhibit 1) was superseded. So also was the obligation of the York Corporation to satisfy the warranties in such contract. The old contract having been satisfied.

> (a) by the York Corporation with respect to the installation and delivery of the plant in a manner acknowledged as satisfactory, and
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> (b) by the petitioner to the extent of the sum of $96,000, being the amount of damages allowed and the initial payment of $12,000.00,

there remained nothing for the York Corporation to do further. There remained for the petitioner (apart from its obligation independently arising to repay a loan and interest) only the obligation to pay $50,000, the balance owing upon the plant. The right to receive and the liability to pay were to continue. Thus, the agreement of settlement was designed to carry forward and preserve the unexecuted and unsatisfied part of the contract (Exhibit 1). Thus, the earlier contract could consistently be rescinded and the subsequent contract relied upon, as found by the Board (R. 27), as fixing "the liabilities and rights of the parties with respect to the said machinery." The provisions of the new contract could safely be accepted as exclusively defining and regulating the rights and obli-

gations of the parties which continued in existence; and the rescission of the earlier contract was in substance a declaration, firstly that the York Corporation had prior thereto carried out its bargain to provide a plant of the specified usefulness, and secondly that the petitioner had satisfied its money obligations except to the extent preserved by the new agreement.

Surely it is not the function of the Court to supervise the negotiations between the parties. The Commissioner of Internal Revenue might have made a better bargain for the York Corporation by rejecting some of the damages as "consequential." But the parties did their own bargaining and came to their own result.

The Court states in its opinion, "The contract of 1930 was never consummated in such manner as to preclude rescission" (R. 99). But the Board found as a fact that the plant was not objected to within thirty days (R. 30). As a result, under the terms of the original contract, this constituted on the part of petitioner, "a complete acceptance of the same as fulfilling all the terms and requirements of the contract relating thereto" (R. 66). But, the contract of sale carried an independent guarantee (R. 59) that the plant would produce ten tons of dry ice in each twenty-four hours. It was the delay in making the plant conform with this guarantee that resulted in petitioner's damages and the Board found that the negotiations with respect to this claim for damages "culminated in an understanding that the York Corporation would allow an adjustment on the transaction in the total sum of $84,800.00, * * *" (R. 26).

No reason indicating a contrary intention of the parties is suggested. The Court has declined to give effect to their expressed agreement to pay damages in the sum of $84,800, stating, "But the York Corporation was unwilling

to give a credit memorandum in this amount, and insisted that the matter be disposed of through the execution of an entirely new contract, in which, under elementary rules of law, the previous negotiations were merged'' (R. 100). This statement is entirely without support.

Why weren't the damages of $84,800 manifested by a credit memorandum? This would appear from the opinion of the Court to be the crucial question. The York Corporation had agreed to allow $84,800 as damages. What intervened to change the character of such allowance? Absolutely nothing. The only thing that happened was that ''After consideration of the matter, however, the York Corporation expressed the desire to dispose of the matter (the allowance of damages) through the execution of a new contract which would definitely fix the liabilities and rights of the parties with respect to the said machinery'' (R. 27). The new contract was suggested by the York Corporation ''in order to clear themselves from further liability under this contract'' (of October 10, 1930, R. 45), and the new contract was agreeable to the petitioner because ''we got our full credit for the $84,800 which we had lost under the first contract'' (R. 45). The York Corporation wanted no further or additional claims to be presented in connection with this transaction and petitioner was satisfied with the allowance of its claim for damages. It is submitted with great earnestness that there is nothing in the record *justifying a deduced finding of fact that the damages were not paid as agreed,* contrary to the express finding of fact that the parties had agreed upon the settlement of damages and had agreed to allow a credit in the amount of $84,800. This credit of $84,800 was actually made under the first contract in the books of the York Corporation (Exhibit 8, R. 47, 83).

In other words, the parties had agreed to a settlement, the form of which was to be manifested by a credit

memorandum, after which the York Corporation "expressed the desire" to adopt a different form. The petitioner was interested only in the amount of the credit and not in the form it was to take. The sworn testimony of the men who negotiated the settlement for both parties expressly excluded any suggestion or inference that the form of the transaction ultimately used represented any change in the intention of the parties as found by the Board.

(c) The Rule Relating to Parol Evidence Cannot Be Invoked by a Stranger to the Instrument

The Circuit Court of Appeals erred in assigning to the language of the agreement an intention contrary to the intention found by the Board. No estoppel could properly be invoked by the respondent against the Petitioner on the basis of the written instrument. The form of the settlement agreement was selected by the York Corporation and the Petitioner for their own purposes. Both of the parties are bound by *their legal act* and the *legal effect accomplished by each in relation to the other party.* As to the effect, in relation to others, of such a writing, Professor Wigmore says (Volume IX on Evidence, 1940 Edition, Section 2446), as follows:

> "But so far as other effects and purposes are concerned, the writing has not superseded their other conduct, nor other persons conduct, and it may still be resorted to for any other purpose for which it is material, either by other persons or by themselves."

This ancient rule has been recognized and applied without qualification by all Federal and State Courts.

> "The familiar rule that an instrument speaks for itself and that parol evidence is not admissible to vary or contradict the terms thereof has little

application to tax cases. It would apply only to agreements between the Commissioner and the taxpayer. Parol evidence is always acceptable where the controversy is not between the parties to the instrument * * *" *Paul and Merten's Income Tax,* Volume 5, Section 43.74.

"It must be remembered that the parol evidence rule does not obtain as to third parties but only between the parties themselves." *Paul and Merten's Income Tax,* Volume 2, Section 11.49.

"The rule (relating to parol evidence to vary or contradict the terms of a writing) is only applicable, however, to controversy between the parties to the instrument and those claiming under them. Where the action is between a stranger and a party to the instrument, either one is in a measure free to vary or contradict it by parol evidence. When the instrument comes in question collaterally, in a suit in which a third party, a stranger to the writings, is a party, neither party is estopped from contradicting it, or from proving facts inconsistent with it." *Holmes and Brewster's Federal Tax Appeals,* 1927, Page 320.

"The rule that parol evidence cannot be received to contradict or vary a written contract, does not apply as against either party in an action between a party to the contract and a third person, as the estoppel on which the rule rests must be mutual, and the third person is not bound by the contract." Syllabus No. 7, *Sigua Iron Company v. Greene,* 88 Fed. 207 (C. C. A. 2nd).

Please see authorities cited at pages 216 and 217 of the report in the Sigua Iron Company case in which *Coke on Littleton* is quoted:

"Every estoppel ought to be reciprocal that is to bind both parties, and this is the reason that regularly a stranger shall neither take advantage of or be bound by an estoppel."

A pronouncement from the opinion of the Supreme Court of North Carolina is cited in this report as follows:

> "They (the strangers are at liberty to show that the written instrument does not disclose the full or true character of the transaction. And, if they be thus at liberty, when contending with a party to the transaction, he must be equally free when contending with them. Both must be bound by this or neither."

The court also quotes with aproval from *McMaster v. Insurance Co.*, 55 N. Y. 222, as follows:

> "Third persons are not precluded from proving the truth, however contradictory to the written statements of others. Strangers to the instrument, not having come into this agreement, are not bound by it, and may show that it does not disclose the very truth of the matter. And as, in a contention between a party to an instrument, and a stranger to it, the stranger may give testimony by parol differing from the contents of the instrument, so the party to it is not to be at a disadvantage with his opponent, and he, too, in such case, may give the same kind of testimony."

> "Likewise there are many other cases which hold that in a controversy between a party to an instrument and a stranger to it, either party may show that the instrument does not speak the truth, and that the general rule does not apply as it does in cases where the controversy arises between the parties who have made an instrument the written memorial of their agreement." *Jones' Commentaries on Evidence*, 1926, Volume 3, Page 2711.

> "In a suit between a party and a stranger, neither is concluded by the contract, but either may give evidence differing from it. *Leo v. Adsit*, 37 N. Y. 78; *McMaster v. Insurance Co.*, 55 N. Y. 222, *Lowell*

Mfg. Co. v. Safeguard Fire Ins. Co., 88 N. Y. 591; *Hankinson v. Vantine,* 152 N. Y. 20, 46 N. E. 292; *Iron Co. v. Greene,* 31 C. C. A. 477, 88 Fed. 207; *Reynolds v. Magness,* 24 N. C. 30; *Dunn v. Price,* 112 Cal. 46, 44 Pac. 354." *O'Shea v. N. Y., C. & St. L. R. Co.,* 105 Fed. 559 at p. 563, (C. C. A. 7).

VI.

CONCLUSION

It is submitted that this case is a simple one, but, that through the application of inferences and conclusions, a basis for tax liability has been erected not only without support in the Findings of Fact but in direct contradiction to the facts. In so disposing of the petitioner's rights as a taxpayer, the Circuit Court of Appeals has rejected a fundamental concept emphasized and reemphasized by this Court and other Federal courts in relation to the review of the decisions of administrative tribunals. It was the burden of the petitioner to establish upon the hearing before the Board of Tax Appeals the facts which proclaimed its exemption under the law from the liability for taxes sought to be imposed by the Commissioner. That it discharged this burden unequivocally and without qualification, is recorded in the Findings of Fact, the only source from which the legal consequences must flow. The Circuit Court of Appeals not only has invoked an irrelevant rule of law to preclude the application of the facts as a basis for liability, but has assumed a series of facts not appearing in the record and in direct opposition to the Findings of Fact upon which the taxpayer is entitled to rest his position. In pursuing this course, the court below has not only affronted the entire body of Federal precedent, but has so far departed from

the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

It is submitted that the foregoing petition for writ of certiorari should be granted.

Respectfully submitted,

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